

An Educational Tax Credit Program

for Financing Higher Education in Missouri

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Problem addressed by this proposed program

Economic development is increasingly dependent on the education, skills, creativity and entrepreneurialism of the workforce (Florida, 2002). Post-secondary education in particular generates important social benefits by increasing the productivity of all workers in a state or region whether they hold post-secondary degrees or not (Moretti, 2004). State governments have traditionally accepted the responsibility for financing part of the cost of higher education by providing public colleges and universities.

At the same time public funding for higher education is declining as state budgets are stretched. Tuition fees have risen as state financing has declined, but the stress on public universities continues to increase. Declining resources for higher education is one of the greatest threats to economic development, and one of the greatest opportunities for innovation.

From the State's perspective, funding higher education as an economic development tool has at least one major drawback. There is no guarantee that the resulting college graduates will lead to economic development within the state since they may find employment elsewhere. Almost all states provide funds to offset the costs of higher education so that in-state students have an incentive to go to college. Subsidized tuition fees are essentially entitlements to students who are residents of the state at the time that they attend a state university. An alternate principle—the one proposed here—would be to shift support to student who are residents of the state following their education.

Main features of this proposal

It is proposed here that all funding for higher education be converted to a higher education tax credit program. State colleges and universities would no longer receive funding for educational programs.² Instead, they would charge all students the same tuition fees (presumably equal to current out-of-state fees). Students who are state residents would be eligible for expanded student loan program which would increase their access to loans sufficiently to cover the difference between current in-state fees and current out-of-state fees. The state would pay the interest on these loans while the

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² This does not apply to state funding support for research, extension, and other parts of the University operation, which would continue as they do now.

borrowers are students at a state university or college.³ Once the student has graduated and taken a job, or started a business in the state, they would be awarded tax credits equal to the difference between in-state and out-of-state tuition fees for the years that they attended a state college or university. These tax credits would be applied against state income taxes over a period of years until exhausted.

The main features of the program would be:

1. Cessation of direct financing for instructional programs at state universities and colleges;
2. An expanded student loan program for Missouri residents. While students are registered students, the State of Missouri would pay the interest charges.
3. A state income tax credit for eligible persons equal to a portion of the tuition fees paid to the state colleges and universities.
4. The tax credit and interest subsidies could be calculated so that they would approximately be neutral in terms of cost to the state treasury.

Optional features

1. Tax credits could be claimed by parents or guardians of the students. This would encourage families to invest in their children's higher education.
2. A secondary market for tax credits could be created by allowing the sale of tax credits. This would allow students that choose to take jobs in other states to recoup some of their tuition fees while supporting in-state companies and residents. This would increase state liabilities, reduce the economic development impacts but increase the demand for University of Missouri entrance.

Economic development implications of this proposal

1. Increased flexibility in the financing of higher education in Missouri. By funding higher education through tax credits, individuals would better recognize the cost of higher education and the benefits of state funding. Tax payers would be more supportive of support for higher education.
2. Improvements in the quality of Missouri's labor force. The tax credits would significantly increase the incentive for college graduates to take positions in the State of Missouri following graduation.
3. The tax credits would indirectly subsidize firms who employ higher skilled and highly educated workers by increasing the supply of these workers.
4. Stimulation of the Missouri economy by injecting funds directly into the economy over a series of years. The funding for higher education would be essentially unchanged since loss of direct state funds would be made up by tuition paid by

³ It is proposed here that all student loan programs be outsourced to commercial lenders who would bid for the right to offer the loans. The state then would be responsible only for paying the interest charges on a portion of the students annual costs of education.

the students. State funds would, instead, be used to increase disposable income of thousands of workers for several years in the future.

Advantages

1. There would be no distinction in tuition fees between residents and non-residents;
2. The program should have no negative effect on the demand for entrance into Missouri's colleges and universities from non-residents since out-of-state fees would not be affected. Demand would probably rise because non-residents would qualify for tax credits, thus effectively reducing their tuition;
3. The program should have little effect on the demand for entrance into Missouri's colleges and universities by residents because their option would be out-of-state fees at other universities and the tax credit program would effectively reduce the cost to current in-state levels;
4. The University would be free to set tuition fees on a competitive and needs basis.
5. There would be a large incentive for graduates to take jobs or start businesses in the state rather than to move out of the state on graduation.
6. There would be an effective subsidy to the higher paying, higher skill-employing employers who hired Missouri graduates.
7. Taxpayers would perceive the State's financial support for higher education as a benefit to them rather than a subsidy to the universities and colleges.
8. The program would be simple. It would add one deduction, not unlike others already there, to the State income tax form.
9. This would be one of the most progressive economic development programs in the country. Depending on the success of this program additional funding could be shifted into educational tax credits as a way of stimulating the economy.
10. This would reduce our current, implicit subsidization of economic development in other states.

Disadvantages

1. Potential "sticker shock." State residents would seem to pay more for their education even though the program could be structured to be neutral or even cost reducing.
2. If the program was extended to all universities and colleges (including private universities) in the state, it could be more expensive than the current system, although this would have an offsetting stimulation of the state economy.

Summary

The proposed program could be designed so that the cost is approximately equal to current levels of support for higher education. The program could be administered at very

low administrative costs since it would be a simple addition to the current state income tax form. The program would focus a very large part of the State's current expenditures on a proven strategy for economic development. It would be both the most progressive state economic development policy in the US and the most innovative strategy for supporting higher education. It would send a very clear signal to employers, employees, and students that Missouri is serious about quality economic development.

Citations

Florida, Richard. *The Rise of the Creative Class. And How It's Transforming Work, Leisure and Everyday Life*. 2002. Basic Books.

Moretti, Enrico. "Estimating the social return to higher education: evidence from longitudinal and repeated cross-sectional data." *Journal of Econometrics* 121 (2004) 175 – 212.